No. 79-1571

Supreme Court, U. S.
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In The

Supreme Court of the United States

October Term, 1979

CHRISTOPHER McGRATH,

Petitioner,

vs.

STEVEN JOHN SLOTKIN, an infant by his mother and natural guardian, CHARLOTTE SLOTKIN and CHARLOTTE SLOTKIN, as Executrix of the Estate of Bert Slotkin, deceased,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION TO THE PETITION FOR A WRIT OF CERTIORARI

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PRELIMINARY STATEMENT

The petition filed by petitioner Christopher McGrath is one of three petitions evolving from the same action below. Respondents have already submitted papers opposing the petition of John McGrath (No. 79-1535) and are submitting opposition papers to the petition of American Mutual (No. 79-1719) concurrently with the instant submission in opposition.

The petitioner raises two arguments not made in the other petitions. Petitioner claims that the fraud action was an impermissible collateral attack on a state court judgment, *i.e.*, the infant's compromise order approving the settlement below the stated (actually misstated) policy limits. In this regard, petitioner characterizes the fraud action as a "second bite of the apple" that "would open the proverbial flood gates" (Petition at pages 10, 15). Petitioner further claims that the Court of Appeals violated the principles established in *Erie R.R. v. Tompkins,* 304 U.S. 64 (1938) by failing to apply the laws of New York State with respect to the scienter requirement for fraud. Each claim is, of course, an attempt to elevate a question of New York law to an issue of constitutional dimensions.

In point of fact, there was no "collateral attack" on a state court judgment. The fact that the infant plaintiff and his mother were fraudulently induced to accept a settlement for far less than the true worth of their malpractice cause of action and the further fact that such settlement was a final disposition of the malpractice claim were necessary elements of the fraud claim. Nor, as we shall show, is there anything novel or remarkable about a fraud action premised on fraudulent inducement to enter into a final settlement of a cause of action. The federal court action sounding in fraud was not a collateral attack on the final settlement of the malpractice action. And, in this context, petitioner's reference as to "a second bite of the apple" is, at the least, misplaced. The entire point of the fraud action was that petitioner's knowing misrepresentations prevented the opportunity for a first bite of the apple.

As for petitioner's claim that the Court of Appeals, a) failed to apply the laws of New York State as to scienter in violation of the *Erie* doctrine, and, b) held that "gross negligence" was sufficient scienter, neither representation is factually correct. First, the decision below was clearly based on New York law. That portion of the decision below addressing the action against

petitioner cites only New York cases (47a-48a).[1] There was no determination to apply federal law or the law of any other jurisdiction. What petitioner really claims is that the court erred in its application of New York law, not that it chose not to apply New York law. Of course, a mere error in the application of state law is just that and is not a refusal to apply state law nor a violation of *Erie*. Petitioner's assertions to the contrary, assertions which reflect a "through the looking glass" logic, clearly reveal that counsel for petitioner suspect, quite rightly, that an alleged error of state law reviewed and re-reviewed by the Court of Appeals is a less than compelling basis for certiorari in the Supreme Court of the United States. In any event, as we shall show, the Court of Appeals did *not* interpret New York law as holding that "gross negligence" is sufficient scienter for fraud.

Finally, as to petitioner's frequent attempts to invoke equitable considerations with references to "a second bite of the apple", and to "floodgates", and to liability for incorrect statements "however innocent", it suffices to note that respondent is a brain-damaged child who was deprived of adequate compensation because a group of attorneys fraudulently induced him to settle for an inadequate amount. Unless the actions of petitioner and the other individual defendants are typical of conduct employed by attorneys, and we hope and believe such is not the case, there will be no "flood of litigation". Furthermore, no one, not respondents, not the trial court in its charge to the jury (reprinted at note 20 of the opinion below, appendix page 48), and not the Court of Appeals, ever suggested that petitioner was liable for all misrepresentations "however innocent". It is precisely because the misrepresentations were not at all innocent that the jury found liability and the Court of Appeals determined that there was sufficient evidence to support the verdict.

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1. All such references refer to pages in petitioner's appendix.

The fact that several attorneys were found liable under New York law for repeated and fraudulent misrepresentations to the attorneys for a brain-damaged infant regarding insurance coverage does not raise issues in law or equity that would warrant a writ of certiorari. Accordingly, respondents respectfully requests that the petition be denied in all respects.

STATEMENT OF FACTS

The instant action for fraud evolves from a state court malpractice case brought by the respondents herein, a brain-damaged child and his mother (22a-23a). On March 4, 1971, the parties to the malpractice action held a settlement conference before New York State Supreme Court Justice Oliver D. Williams (30a). At that time, petitioner Christopher McGrath, the attorney for Citizens Casualty who was representing the defendant hospital, told the respondents' attorney, Mr. Max Toberoff, that the total insurance coverage, including reinsurance, was $200,000. Indeed, Mr. McGrath stated that he *knew* the total coverage was only $200,000. The following exchange occurred on the record:

> "Mr. [Christopher McGrath]: *The total coverage is $200,000, including reinsurance.*
>
> Mr. Toberoff: So far as you are concerned.
>
> Mr. McGrath: Correct.
>
> Mr. Toberoff: You have no knowledge as to whether the hospital has additional coverage with other companies? You have no knowledge of that?
>
> Mr. McGrath: *I do have knowledge of that.* We were the only company on the line at that time" (emphasis added) (30a-31a, n.7).

Mr. McGrath further stated that his knowledge was based on an examination of his file.

Based upon Mr. McGrath's representations and other representations as to the policy limits, respondents entered into a stipulation of settlement on March 4, 1971 (reprinted at 31a). The stipulation settled the malpractice claim for $185,000, $15,000 less than the stated policy limits.

In point of fact, there was an additional $1 million in reinsurance as of the time Mr. McGrath adamantly insisted that the coverage was only $200,000 (34a). Moreover, his own file, the file he insisted showed insurance for only $200,000, was rife with correspondence indicating the fact and amount of the reinsurance (32a).

A week to ten days after the parties entered into the stipulation on the record, Christopher McGrath, apparently on the insistence of Ratner, advised Justice Williams and Toberoff of the $1 million in excess insurance (33a-34a). Justice Williams, who had not yet signed an infant's compromise order under CPLR §1207, then held a conference on March 31, 1971 (34a).

As of this time, respondents could have avoided settlement and asked for a retrial of the malpractice claim. However, Mrs. Slotkin, who had testified at trial, had not fully recovered from a heart attack and her physician stated that she should not testify again (36a). Also, all of respondents' expert witnesses indicated that they could not testify again (*id.*). In this regard, the Court of Appeals found that "although it is true that plaintiffs could have avoided going through with the settlement, this does not diminish the prejudice that they have already suffered by irrevocably changing their position" (44a). As the Court of Appeals noted:

> "Plaintiffs have never had the opportunity to avoid any injury. Plaintiffs were already injured,

> and their only choices were to accept the settlement and sue for fraud or to retry the malpractice case with all that retrial involved in terms of obtaining witnesses and the like. Given these choices, their decision to proceed by way of the fraud action was understandable . . ." (44a-45a).

On June 4, 1971, Justice Williams signed an infant's compromise order approving the settlement (37a). As of this time, he and the parties knew full well that respondents intended to bring an action sounding in fraud (*id.*).

A full jury trial of respondents' fraud case was held in the District Court for the Southern District of New York before Judge Pollack. As might be expected, the trial was protracted for respondents were, in effect, required to try two cases in one — the merits of the case sounding in fraud and the merits of the state court malpractice case (the case within the case).

With respect to the scienter requirement for fraud, Judge Pollack charged the jury:

> "A person makes a misrepresentation with scienter, meaning knowingly, if he knows that the representation is false, or he neither knows nor cares whether it is true or false, of if he has no genuine belief that it is true. *If a speaker actually believes that what he says is true, then he does not act with scienter, even though that belief is negligent, in that a reasonable man would not believe it.*
>
> *There is one exception to what I have just told you. If you find that the defendant whom you are considering intended that it should be*

> *understood that what he said about the hospital's insurance was true to his personal knowledge and intended that the plaintiffs should act on the basis of what he said, then you should find that said defendant acted with scienter if he didn't know what he [said] was true.* To this extent, a person who asserts a falsehood as true to his personal knowledge may be said to have acted with scienter, that is, knowingly, even though he believes what he says to be true" (emphasis added) (48a, n.20).

At the close of respondents' case, Judge Pollack dismissed claims against the reinsurers. At the conclusion of the trial, the jury returned a verdict in favor of respondents herein and against, among others, the petitioner herein, Christopher McGrath (50a).

Subsequent to the jury's verdict in favor of respondents, Judge Pollack granted defendants' motion for a directed verdict and dismissed respondents' complaint as to all named defendants including petitioner Christopher McGrath. Judge Pollack's decision appears on pages 1 through 16 of petitioner's appendix. A reading of that decision will clearly show that the dismissal of the complaint was based on one and only one basis — Judge Pollack's belief that, *under the law of New York,* a victim of misrepresentation waives the fraud if he proceeds to execute the agreement notwithstanding his awareness of the misrepresentation. In other words, Judge Pollack believed that, by enforcing the $185,000 settlement after they became aware of the excess coverage, respondents herein waived any claim for fraud which may have existed under New York state law.

Respondents appealed to the Court of Appeals for the Second Circuit. Respondents there claimed that the District Court erred in its interpretation of the law of the State of New

York and that the enforcement of the $185,000 settlement did not, under New York law, constitute a waiver of the claim for fraud. The Court of Appeals, in a lengthy opinion which occupies pages 20 to 57 of petitioner's appendix, agreed. Accordingly, the Court reversed the District Court's direction of judgment notwithstanding the verdict and ruled that respondents may either reinstate the verdict and judgment of $680,000 against petitioner Christopher McGrath (among others), or may retry the case against the defendants (including the present petitioner and the reinsurers and excepting defendant George Berkowitz since the court determined that there was insufficient evidence to support a verdict against defendant Berkowitz).

An analysis of the decision of the Court of Appeals reveals that said decision rested entirely on New York law. Thus, the court held:

> "The law of New York is clear that one who has been induced by fraudulent misrepresentation to settle a claim may recover damages without rescinding the settlement." (42a).

Indeed, the court explicitly stated that, even if it believed the New York rule to be unsound, "we would of course nevertheless be bound by that rule" (*id.*).

Petitioner Christopher McGrath now petitions this Court for a writ of certiorari. Several of petitioner's arguments were made in the other petitions and will not be addressed herein. In particular, petitioner's waiver argument was suitably disposed of in Judge Oakes' well-reasoned opinion. *See* pages 41-47 of petitioner's appendix. We do, however, address two points raised now by petitioner Christopher McGrath and not raised by the other petitioners.

REASONS FOR DENYING THE WRIT

I.

The federal action cannot possibly be construed as a collateral attack on a state court judgment.

Petitioner correctly notes that the signing of the infant's compromise order constituted a final disposition of the state malpractice action. However, this fails to advance petitioner's claim that the institution of the federal action sounding in fraud constituted on impermissible collateral attack on a state court judgment.[2] The fact that the action for malpractice was finally settled for the sum of $185,000 was a necessary element of the fraud claim. Absent the final settlement of the malpractice claim, respondents could not have shown any damage arising from the fraud.[3] Nor can there be any claim that the action sounding in fraud was the same cause of action as that sounding in malpractice. Clearly, it was not. The fraud claim required proof of elements not required in the malpractice action. And the recoverable damages in the fraud action were the probable worth of the malpractice claim minus those damages actually recovered in the settlement of the malpractice action.

Assuming that the settlement order, as a final disposition of an action, should be regarded as a state court judgment, it has long been New York law that a judgment procured by fraud gives rise to a separate cause of action for fraud under New

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2. Actually, no judgment was entered in the state court action. This, of itself, indicates that the federal action cannot be construed as a collateral attack on a state court judgment.

3. Again, we do not address petitioner's claim that the acceptance of final settlement constituted a waiver of the fraud claim because this argument is, we believe, completely demolished in the opinion below. *See* pages 41a-46a of petitioner's appendix.

York law which cannot be regarded as an attack on the first judgment. The earlier judgment is viewed as one of the means of creating the damage, *Verplank v. Van Buren,* 76 N.Y. 247, 261 (1879), and, for that reason, "did not constitute an adjudication upon the question of fraud, barring the plaintiffs' claim in this action." *Strong v. Strong,* 102 N.Y. 69, 75 (1886). To the same effect is *Young v. New York State E. & G. Corp.,* 184 Misc. 1013, 55 N.Y.S. 2d 150 (Sup. Ct., Steuben Co., 1945), *aff'd,* 270 App. Div. 794, 60 N.Y.S. 2d 303 (4th Dept. 1946):

> "*The Surrogate's orders approving the settlements do not bar the prosecution of these actions.* If the actions were for rescission or based upon rescission, it might be necessary for plaintiffs first to have the orders of the Surrogate evoked or modified. McNamara v. Eastman Kodak Co., 232 N.Y. 18, 27, 133 N.E. 113, 116. Here rescission is not involved; plaintiffs have affirmed the settlements and elected to sue for damages claimed to have resulted from the fraud under the 'second' alternative mentioned in *Urtz v. New York Cent. & H.R.R. Co., supra*" (emphasis added) (55 N.Y.S. 2d at 154).

The point was clarified in *Crouse v. McVickar,* 207 N.Y. 213 (1912), a case which petitioner inexplicably cites in his petition. There, the court explained:

> "It is doubtless true that a judgment can be set aside for fraud by an action brought for that purpose, but it is the settled law (save possibly in one or two jurisdictions) that the fraud for which a judgment can be impeached must be in some matter other than the issue in controversy in the action" (207 N.Y. at 218).

In *Crouse*, the fraud was perjury committed on the very issue in dispute in the prior litigation. But this is no perjury case. We are concerned with out-of-court misrepresentation on the subject of insurance coverage, an issue entirely foreign to the state court litigation and which would, in fact, have caused a mistrial if mentioned therein.

As has been shown, New York law clearly recognizes a cause of action sounding in fraud and arising out of the final disposition of another cause of action. For this reason, petitioner's claim that the federal action constituted an impermissible collateral attack on a state court judgment is devoid of merit. This aside, it cannot be denied that the Court of Appeals considered the collateral attack argument and rejected that argument on the basis of New York law.[4] Thus, properly

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4. The Court of Appeals held (42a, 43a):

> "The law of *New York* is clear that one who has been induced by fraudulent misrepresentation to settle a claim may recover damages without rescinding the settlement. Strong v. Strong, 102 N.Y. 69, 73, 5 N.E. 799, 800 (1886); Byrnes v. National Union Insurance Co., 84 A.D.2d 872, 310 N.Y.S.2d 781 (1970); Inman v. Merchants Mutual Casualty Co., 274 A.D. 320, 323-24, 83 N.Y.S.2d 801, 804 (1948).
>
> Even if the underlying premises of this New York rule allowing rescission on the one hand or ratification and suit for damages on the other were unsound, we would of course nevertheless be bound by that rule. The premises for rule, however, are quite sound. If all that will result from a misrepresentation is a new trial, then the party making it has everything to gain and nothing to lose. The plaintiffs would be placed at a disadvantage by a new trial; the defendants would not. If anything, defendants would benefit by having a preview of plaintiffs' case."
>
> * * *

(Cont'd)

speaking, there is no issue of federal law notwithstanding petitioner's attempt to create an issue of federal law. And, as with the other petitioners, this Court is being asked to review and reverse a lower court determination of state law. It is respectfully submitted that such request presents a less than compelling basis for a grant of writ of certiorari.

II.

There was ample evidence to support the jury finding of scienter under New York law.

As already noted, Christopher McGrath stated on the record and during the March 4 negotiations that he did know the extent of coverage and that his file "shows the limits of $200,000". At trial, his "excuse" was that he had not fully examined his file as of that time. Of course, whether this was true or not, the fact is that Mr. McGrath either lied about the insurance coverage, or at the very least, pretended to an absolute and personal knowledge he did not have. Moreover, it is clear that, as of the time the representations of absolute and personal knowledge were made, McGrath knew full well that respondents were relying on the representations of coverage. Yet, McGrath not only misrepresented the amount of insurance coverage while in possession of a file showing the true amount of coverage, he went to great pains to assure everyone that his knowledge as to the amount of coverage was complete, correct and based on actual examination of his file. It is, therefore, somewhat remarkable that petitioner characterizes the finding of liability as indicating that attorneys can now be held liable for

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(Cont'd) "Thus, the New York rule serves to deter fraud. Moreover, the rule does not present a problem of double recovery. In this case, for example, Judge Pollack appropriately instructed the jury that in fixing damages it should deduct from the 'fair settlement value' the $185,000 received under the settlement."

misstatements "however innocent". There was nothing innocent about pretending to absolute and personal knowledge of insurance coverage, misstating the insurance coverage, and thereby inducing settlement of a brain-damaged infant's case for a fraction of its true worth.

New York law provides that scienter is satisfied by recklessness or the pretense of knowledge when knowledge there is none. *Ultramares Corp. v. Touche,* 255 N.Y. 170, 179 (1931). As noted in *Hadcock v. Osmer,* 153 N.Y. 604, 608 (1897):

> "Where a party represents a material fact to be true *to his personal knowledge,* as distinguished from belief or opinion, when he does not know whether it is true or not and it is actually untrue, *he is guilty of falsehood, even if he believes it to be true,* and if the statement is thus made with the intention that it shall be acted upon by another, who does so act upon it to his injury, the result is actionable fraud" (emphasis added).

Accordingly, the Court of Appeals held:

> "McGrath's insistence that the policy limit was $200,000, see note 7 supra, renders him liable under New York definition of scienter as 'a reckless indifference to error,' 'a pretense of exact knowledge', or 'an assertion of a false material fact' 'susceptible of accurate knowledge' but stated to be true of the personal knowledge of the representer. See Burgundy Basin Inn v. Watkins Glen Grand Prix, 51 A.D.2d 140, 379 N.Y.S.2d 873, 879 (1976), and cases cited. This, of course, attunes with the classic formulation of Judge

> Cardozo in the touchstone case of Ultramares Corp. v. Touche, Niven & Co., 255 N.Y. 170, 174 N.E. 441, 449-50 (1931)" (47a-48a).

The charge to the jury correctly stated the New York scienter requirement. The Court of Appeals concluded that there was sufficient evidence to support the jury finding of scienter. It is respectfully submitted that neither the Court of Appeals' formulation of New York law as to scienter nor the jury's finding of fact as to scienter warrants review by the Supreme Court of the United States.

CONCLUSION

For all of the above stated reasons petitioner's application for a writ of certiorari should be denied in all respects.

Respectfully submitted,

s/ Theodore H. Friedman

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